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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.
No. 400

CONSOLIDATED ROCK PRODUCTS CO., a corporation, and EDWARD F. HATCH and LOUIS VAN GELDER, composing the Preferred Stockholders' Committee of Consolidated Rock Products Co.,

Petitioners,

vs.

E. BLOIS DU BOIS, an objecting bondholder of record in the Plan of Reorganization,

Respondent.

BRIEF FOR RESPONDENT.

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SUBJECT INDEX.

TABLE OF AUTHORITIES CITED.

CASES.

STATUTES.

BLANK PAGE

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BRIEF FOR RESPONDENT.

Opinions Below.

The judgment of the District Court affirming the plan of corporate reorganization herein involved [R. 231-265] was filed September 8, 1938. The first opinion of the Circuit Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court, one judge dissenting. It was filed November 4, 1939, and is reported in 107 Fed. (2d) 96, Advance Sheets. On respondent's petition

for rehearing the Circuit Court of Appeals vacated its decision and the judgment thereon and granted rehearing [R. 363-364]. On June 19, 1940, the second opinion of the Circuit Court of Appeals, reversing the judgment of the District Court, was filed [R. 365-380]. It is reported in 114 Fed. (2d) 102, Advance Sheets.

Jurisdiction.

Petitioners filed petition for rehearing on July 19, 1940. The petition was denied on August 5, 1940 [R. 382-383]. A petition for a writ of certiorari was filed in this Court on September 6, 1940, and was granted October 28, 1940.

Petitioners have invoked the jurisdiction of this Court under Section 240 (a) of the Judicial Code as amended (28 U. S. C. A. 347 (a)).

Questions Presented.

On this review the questions presented are:

1. Did the Circuit Court of Appeals correctly rule that a determination with respect to the indebtedness owing by Consolidated Rock Products Co., the parent corporation, to its two subsidiaries, Union Rock Company and Consumers Rock and Gravel Company, Inc., is essential to decision as to the extent of the property against which creditors of the subsidiaries are entitled to full and absolute priority to the extent of their debts?

2. Did the Circuit Court of Appeals correctly rule that a determination with respect to the value of the various properties involved in the reorganization is essen-

tial to a decision as to the participation, if any, which may be accorded stockholders in any plan of reorganization?

3. Does the decision of the Circuit Court of Appeals, properly construed, rule that in any future plan of reorganization which may be presented, a common issue of bonds, with common security, cannot be substituted for the separate and distinct bond issues of the subsidiary corporations now outstanding; and, if so, is such ruling correct?

4. Did the Circuit Court of Appeals correctly rule that the plan of corporate reorganization proposed in these proceedings is unfair and inequitable in failing to accord to bondholders, as creditors of the subsidiary corporations involved, full and absolute priority to the extent of their debts against all the property of their debtors?

Statute Involved.

The statute involved is Section 77B (f) of the Bankruptcy Act (11 U. S. C. A. 207 (f)), the pertinent portion of which reads as follows:

> After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that (1) it is fair and equitable and does not discriminate unfairly in favor of any claims of creditors or stockholders, and is feasible. * * *

STATEMENT OF THE CASE.

1. The Parties to the Case.

For brevity, Consolidated Rock Products Co. will hereinafter be referred to as "Consolidated", Union Rock Company as "Union" and Consumers Rock and Gravel Company, Inc., as "Consumers".

The plan of reorganization here involved was presented by the debtor, Consolidated, the Union Bondholders' Protective Committee and the Consumers Bondholders' Protective Committee [R. 20], who, with the Preferred Stockholders' Committee of Consolidated, were the appellees before the Circuit Court of Appeals. Objections to the plan were filed by respondent [R. 95-128], the owner of First Mortgage Serial and Sinking Fund Gold Bonds of Union in the principal amount of $150,000, and of like bonds of Consumers in the principal amount of $31,500 [R. 156]. The plan was confirmed after hearings before a Special Master and the District Court [R. 231-265]. The subsequent appellate proceedings are indicated in respondent's opening statement covering the opinions below.

The first decision of the Circuit Court of Appeals—affirming the judgment of the District Court confirming the plan—was handed down two days before the announcement of the decision of this Court in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106. On granting respondent's petition for rehearing the Circuit Court of Appeals directed the filing of further briefs with respect to the applicability of that decision to the instant case.

Thereupon the Securities and Exchange Commission and Edgar Shook, Esq., independently of each other, sought and received permission to file briefs as *amici curiae* [R. 373].

On this review only Consolidated and its Preferred Stockholders' Committee attack the correctness of the decision below in so far as it rules the plan to be unfair. In Docket No. 444 the Union and Consumers Bondholders' Protective Committees, appellees below, seek modification of the decision only. They are supported in their position by the memoranda filed by the Solicitor General for the Securities and Exchange Commission and the Interstate Commerce Commission, appearing as *amici curiae*. The memorandum of the Securities and Exchange Commission, however, supports the position of respondent that the decision of the Circuit Court of Appeals, in so far as it rules the plan to be unfair, is correct.

2. The Relationship of the Corporations Involved in the Reorganization.

Consolidated was organized January 28, 1929. It has no bonded indebtedness, but has issued and outstanding 285,947 shares of no par preferred stock, and 397,455 shares of no par common stock [R. 111].

In the year of its organization Consolidated purchased all outstanding stock of Union and Consumers, both of which were then important factors in the rock, sand and gravel industry of Southern California [R. 132-136]. This was the purpose of the organization of Consoli-

dated [R. 134]. Both Union and Consumers then had outstanding their present bond issues, secured by trust indentures upon their respective properties [R. 134]. Both issues have since been reduced by retirement of bonds. Union now has outstanding bonds in the hands of the public aggregating in principal amount $1,871,000; the aggregate principal amount of Consumers bonds now publicly held is $1,137,000 [R. 189]. Consolidated by its purchase of the outstanding stock of Union also gained control of Reliance Rock Company, a wholly owned subsidiary of Union [R. 133; 160], as well as certain other of Union's wholly owned subsidiaries [R. 319].

After purchase of Union and Consumers by Consolidated an operating agreement was entered into by the three companies. Reliance Rock Company, although a wholly owned subsidiary of Union, joined in the agreement. The agreement bore date July 15, 1929, but was made effective as of April 1, 1929 [R. 160-175]. The purpose of this operating agreement apparently was to permit Consolidated to operate all the companies as a unit while each maintained its separate legal status. Under the agreement the subsidiaries transferred to Consolidated all of their cash, securities, notes and bills and accounts receivable, book accounts, manufactured materials and materials in process, raw materials not in place, supplies actually on hand and contracts for the sale of materials [R. 162]. They gave Consolidated the full right to operate their plants and other properties [R. 165]. Consolidated agreed, among other things, to main-

ain the properties [R. 166]; to keep full and complete ccounts of inter-company transactions (including proper ntries with respect to depreciation, depletion, amortiza- ion and obsolescence of the various properties) [R. 167]; o pay Union and Consumers from time to time all mounts necessary to comply with the provisions of their espective trust indentures [R. 167-168]; and to pay all perating expenses [R. 170-171]. Consolidated in return as authorized by the operating agreement to retain for s own use and benefit all net revenue resulting from peration of the properties [R. 170-171].

After execution of this operating agreement Union, eliance and Consumers ceased to exist as operating mpanies, and Consolidated assumed every function of anagement and ownership [R. 140-141].

A purported modification of the original operating greement was entered into on February 16, 1933 [R. 76-182]. It was executed on behalf of Consolidated by s President, F. J. Twaits, and its Secretary, Robert itchell, each of whom acted in the identical capacity for ch of the subsidiary companies [R. 140-141].

Consolidated continued operation of all the companies nder the operating agreement to the date of institution proceedings for reorganization [R. 270]. Since then has continued operation as a debtor left in possession.

THE PLAN

1. Factual Background Upon Which the Fairness of the Plan Must Be Determined.

The treatment of Union and Consumers bondholders must be judged in the light of existing facts shown by the record.

It must be noted, first of all, that the only parties having any interest in this reorganization are (a) the bondholders of Union and Consumers; (b) Consolidated, as the sole stockholder of Union and Consumers; and (c) indirectly through Consolidated, the preferred and common stockholders of that corporation. There are no junior lienholders or unsecured creditors to be considered except as account must be taken of the unsecured indebtedness owing by Consolidated to Union and Consumers [R. 314]. For all practical purposes we may eliminate Consolidated as an interested party and substitute its preferred and common stockholders in its stead. Consideration may be further simplified by also eliminating the common stockholders of Consolidated. They have no equity. The plan tacitly concedes this by its treatment of them [R. 31]; the books of Consolidated establish the fact [R. 314]; and the Special Master so found [R. 153]. Since all equity under the Union and Consumers bonds is vested in the preferred stockholders of Consolidated, we must examine the plan's treatment of Union and Consumers bondholders with full appreciation of the resultant effect of such treatment upon the subordinate position of the equity holders.

Treatment of the bondholders must also, of course, be examined with reference to the findings of the Special Master as to the extent and value of the properties against which bondholders are entitled to full priority over stockholders. He found that the value of the assets admittedly subject to the Union and Consumers trust indentures is insufficient to discharge the principal and accrued interest of the bonds [R. 153]. A value of "approximately" $3,300,000 was placed by him on the combined properties of the two subsidiaries [R. 151]. For some reason the Special Master did not deem it necessary to make separate findings as to the value of the Union and Consumers assets. His combined valuation is evidently an average of the valuations given by all witnesses who testified to value. Their testimony was as follows, figures with respect to Union and Reliance being grouped:

Witnesses		*Union*	*Consumers*
Mitchell	[R. 281-282]	$2,150,200	$1,267,100
Gautier	[R. 290]	$1,940,000	$1,436,000
Rogers	[R. 291-292]	$2,518,000	$ 750,000
Average		$2,202,733	$1,151,033

It will be noted that the total of the two averages is $3,353,766, or $53,766 in excess of the Special Master's "approximate" finding.

The aggregate principal amount of Union and Consumers bonds publicly held is $3,014,000 [R. 189]. The principal of the bonds is therefore secured more than 100%, with a surplus in assets of $286,000 for payment of accrued interest. Such accrued and unpaid interest

on the publicly owned bonds, computed to April 1, 1937, amounts to $625,270 [R. 191-192].[1]

The valuation of $3,300,000 is plainly intended by the Special Master to apply to the assets "admittedly subject to the trust indentures" of Union and Consumers [R. 152-153]. Such assets, however, are not the only assets against which bondholders of those corporations are entitled to full priority over preferred stockholders of Consolidated. The Special Master made no finding as to the Union and Consumers assets not "admittedly subject to the trust indentures", ignoring the existence of the indebtedness owing by Consolidated to Union and Consumers under the operating agreement. The record shows this indebtedness to be in excess of $5,000,000 after all set-offs and after allowance on account of the $166,000 of Union and Consumers bonds held by Consolidated [R. 281; 316, 312]. The Special Master found the assets of Consolidated to have a value of $1,000,000, provided $500,000 for good will is included [R. 151].[2]

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[1]While the new bonds under the plan will be dated as of April 1, 1937, the plan was not confirmed by the District Court until September 8, 1938. Accrued and unpaid interest on the publicly owned bonds as of September 1, 1938, the approximate date of the order of confirmation, would be $256,190. more than the figure as of April 1, 1937, or a total of $881,460. These figures do not take into consideration the right of the bondholders to interest on the delinquent interest.

[2]The Special Master in reality did not find the value of the good will of Consolidated to be $500,000. He said that "according to Mr. Mitchell's testimony, and including $500,000. for good will and going business value, the total value of the properties of Consolidated would be approximately $1,000,000. . . ." [R. 151.] Mr. Mitchell was the only witness who expressed any opinion with respect to the value of the good will.

2. The Plan's Treatment of Union and Consumers Bondholders.

The plan of reorganization [R. 20-65] contemplates a new corporation to which all properties of Union and Consumers, together with the allegedly free assets of Consolidated, will be transferred, discharged of all liens and claims [R. 26]. The new corporation will issue new 5% bonds, maturing 20 years after April 1, 1937, in the principal amount of $1,507,000, secured without distinction by lien upon all the properties transferred to it. The new bonds will be divided into Series U and Series C, comprising principal amounts of $938,500 and $568,500, respectively [R. 27].

At present Union bonds in the principal amount of $1,979,500 remain outstanding, of which bonds in the principal amount of $102,500 are held by Consolidated [R. 189]. Consumers bonds in the principal amount of $1,200,500 remain outstanding at this time, of which bonds in the principal amount of $63,500 are held by Consolidated [R. 189].

Under the plan present Union bondholders will receive a new Series U bond in the principal amount of $500 for each $1,000 in principal amount of present bonds held. Present Consumers bondholders will receive like distribution of the Series C bonds [R. 28-30]. The Union and Consumers bonds held by Consolidated will be cancelled [R. 79].

The new corporation will also issue 30,140 shares of 5% preferred stock of the par value of $50 per share,

divided into 18,770 shares of Series U preferred stock and 11,370 shares of Series C preferred stock. Present Union bondholders will receive 10 shares of the Series U preferred stock having a total par value of $500 for each $1,000 in principal amount of present Union bonds held. Present Consumers bondholders will receive like distribution of the Series C preferred stock [R. 28-30].

Series U and Series C preferred stock will be non-cumulative until all new bonds of the corresponding series are retired [R. 47].

Both series of preferred stock will carry stock purchase warrants entitling holders to purchase common stock of the new company at $2.00 per share during the first six months, at $4.00 per share during the second six months, at $4.50 per share during the second year, at $5.00 per share during the third year, at $5.50 per share during the fourth year, and at $6.00 per share during the fifth year. Each share of the preferred stock will carry with it the right to purchase two shares of the new common stock on the basis stated.

The new bonds will be income bonds although the stipulated interest is 5%. Not exceeding 50% of the "available net income" of the new corporation, as defined in the plan [R. 37-40], will be applied first to servicing the Series U bonds and preferred stock and meeting certain sinking fund requirements; not exceeding 50% thereof will be applied to like purposes with respect to the Series C bonds and preferred stock. Any surplus net income will be available for general corporate purposes [R. 40-42].

The plan cancels accrued and unpaid interest on the presently outstanding Union and Consumers bonds [R. 26]. As noted, this interest, as of April 1, 1937, the date as of which the new bonds will be issued, amounts to $625,270.00, computation being made on the basis of publicly held bonds only [R. 191, 192].

The plan also cancels all inter-company obligations [R. 26].

3. The Plan's Treatment of the Preferred and Common Stockholders of Consolidated.

The provisions of the plan with respect to the preferred and common stockholders of Consolidated are in striking contrast to the drastic treatment accorded Union and Consumers bondholders.

The new corporation will issue 425,718 shares of common stock, par value $2.00 per share [R. 27]. Of these shares present preferred stockholders of Consolidated will receive 285,947 on the basis of one share for each share of the present Consolidated preferred stock held by them [R. 31]. No payment or additional contribution is required of them.

The holders of the present common stock of Consolidated will receive stock purchase warrants entitling them at any time within three months to purchase one share of the new common stock for each five shares of present Consolidated common stock held, at a purchase price of $1.00 per share [R. 31].

60,280 shares of the common stock will be reserved for issuance upon possible exercise of stock purchase warrants attached to new Series U and Series C preferred stock [R. 27].

ARGUMENT.

Summary.

Since any indebtedness owing to Union and Consumers is an asset against which their bondholders are entitled to full priority to the extent of their debts over stockholders, the Circuit Court of Appeals correctly ruled that the $5,000,000 claim of Union and Consumers against Consolidated under the operating agreement must be determined, "voluntarily or by litigation". Likewise the Circuit Court of Appeals correctly ruled that in order to apply the full priority rule, accurate determination must be made of the value of the properties of the various corporations involved in the reorganization.

The decision below does not, as contended by petitioners, hold the plan to be unfair because of the substitution of a common issue of bonds with common security for the present Union and Consumers bonds.

As held by the Circuit Court of Appeals, the plan here is unfair in its disregard of the full priority rule and discriminates unfairly in favor of the present stockholders of Consolidated. In final analysis the plan sanctions a repudiation of corporate debt and the appropriation of properties, upon which the bondholders have existing claims, to enrich the stockholders of Consolidated.

POINT I.

The Indebtedness of Consolidated to Union and Consumers.

Petitioners first attack the decision of the Circuit Court of Appeals because of its reference to the indebtedness owing by Consolidated to its subsidiaries under the operating agreement.

As noted, the plan cancels all inter-company obligations, resulting in discharge of an indebtedness of Consolidated to Union and Consumers under the operating agreement in excess of $5,000,000 after all set-offs and after allowance on account of the $166,000 of Union and Consumers bonds held by Consolidated [R. 281, 316]. The fairness of the plan in this respect was questioned by respondent in the District Court by his Objection IV (4) [R. 100], and he prayed that definite determination be made of all inter-company obligations [R. 107]. The failure of the Special Master to make any findings concerning the operating agreement, or the huge indebtedness of Consolidated thereunder shown by the evidence, was attacked by respondent's Exceptions VI and VII [R. 201]. Denial of these exceptions was assigned as error on appeal, as was the cancellation of the inter-company obligations [R. 331].

Heretofore Consolidated has denied liability under the operating agreement [R. 276].

In speaking of the claim of Union and Consumers against Consolidated the Circuit Court of Appeals said:

> "It can be seen therefore that until the claim is settled, either voluntarily or by litigation, there is no way to determine the fairness of any plan of re-

> organization, because until it is known what assets are subject to payment of the bonds, we have no way of knowing what the bondholders will lose, if anything." [R. 374.]

Petitioners first attack this language as a specific ruling that any dispute as to the rights and liabilities of the parties to the operating agreement cannot be compromised, and as a general ruling condemning compromises in §77B proceedings. The plain language of the court carries no such implications. The court states simply that the claim here involved must be determined; it leaves to the parties whether such determination shall be made "voluntarily or by litigation". Voluntary settlement of necessity implies the right of compromise.

In the instant case respondent by appropriate pleading questioned the fairness of the plan in cancelling the inter-company obligations resulting from the operating agreement. The issue raised, bearing as it did on the fairness of the plan, should have been determined by the District Court. Since the institution of these proceedings there has never been, nor is there now, any necessity for "litigation" of this issue outside of these proceedings. It is inextricably involved in the fairness of any plan of reorganization which may be presented, and the jurisdiction of the District Court to determine the issue cannot be disputed.

This is the type of "litigation" referred to by the Circuit Court of Appeals in the quoted portion of its decision.

Petitioners' second attack upon the quoted portion of the decision is upon the ground that it constitutes an improper repudiation of a compromise with respect to the operating agreement and the inter-company obligations worked out by the negotiators of the plan. Some

language of petitioners' brief would indicate that they question the right of the court to inquire into the details or propriety of a compromise embodied in a plan of reorganization, regardless of how seriously such compromise may affect the fairness of the plan.

In reality, however, there was no compromise with respect to the rights and liabilities of the parties to the operating agreement. Compromise implies some give and take, which is entirely absent in the cancellation of the inter-company obligations. The indebtedness of Consolidated was simply arbitrarily cancelled. No mention of any such compromise is made in the plan, although a separate article is devoted to the cancellation of the $166,000 of Union and Consumers bonds held by Consolidated [R. 55]. The negotiators were seemingly satisfied that the enterprise as a whole was solvent, and took the position that (1) Consolidated and its stockholders were therefore possessed of an equity which justified some preferred stockholder participation under the plan, and (2) that, the enterprise being solvent, any indebtedness of Consolidated under the operating agreement was in fact owed by it to itself. This is indicated by the evidence [R. 277] and is reflected by the judgment of the District Court [R. 253-254]. Assuming solvency this position was entirely sound except as it overlooked the fact that bondholders of Union and Consumers would have to be made whole before their rights against the indebtedness owing by Consolidated to their debtors could be ignored.

On this review petitioners, for the first time, admit that Consolidated is bound by the operating agreement of July 5, 1929. They now say that the dispute with respect to the indebtedness of Consolidated to Union and Consumers revolves around the "contention of the objecting bondholder . . . that the agreement of 1933 is void". The agreement referred to is the amendment to the original operating agreement. It is true that respondent has attacked the validity of this amending agreement upon the grounds that it was not supported by real consideration, that there was no reality of consent to the amendment by the subsidiaries, and that the amendment is a patent fraud upon the subsidiaries and their bondholders. In view of the changed position of petitioners, however, the validity of the amendment need not be discussed here. Petitioners no longer deny liability; they simply contend (1) that the extent of Consolidated's liability must be determined by a board of appraisers upon termination of the operating agreement as provided by the 1933 amendment and (2) that any indebtedness of Consolidated to the subsidiaries may then be paid, 25% in equal annual installments over a period of ten years, and the remaining 75% at the end of the tenth year. Consequently, they say, there is no "present liability" of Consolidated to Union or Consumers.

The argument overlooks the fact that the consummation of the plan will terminate the operating agreement and also that even under the amendment to the operating agreement of 1933 the only indebtedness of Consolidated

which could be deferred is "the portion . . . . represented by 'depreciation' . . . ." [R. 179]. However, that a present liability exists goes without saying, regardless of whether in the absence of these proceedings and of the plan's cancellation of inter-company obligations Consolidated might elect to discharge its indebtedness over a period of years. On this review it is the existence of the indebtedness that is important; it is unimportant for all practical purposes whether the indebtedness owing by Consolidated is $5,000,000 or merely $1,000,000, or how payment was originally provided to be made. The Special Master found the value of the Union and Consumers properties to be $3,300,000. This figure is roughly 25% of the inflated book value of $13,500,000 at which petitioners say these properties were carried on the books, and on the basis of which depreciation, depletion and obsolescence credits to the subsidiaries were given. If we assume, then, that the $5,000,000 indebtedness of Consolidated should be reduced by 75% the indebtedness is still $1,250,000. So far as the fairness of the plan here involved is concerned, the result is not changed.

Petitioners argue that the "compromise" should be sanctioned because the debt could be reached by bondholders only after foreclosure and entry of a deficiency judgment, and also because of the provision of the operating agreement that it is not made for the benefit of third parties. It is not readily perceptible how such considerations can possibly justify cancellation of Consolidated's debt to the subsidiaries, against which the bondholders are

entitled to full priority over stockholders to the extent of their debts. Petitioners refer to Section 726, *California Code of Civil Procedure,* set forth in their appendix, as limiting any deficiency judgment which might be obtained to the difference between the aggregate bonded indebtedness and the appraised value of the property as of the date of sale. The code section referred to would not apply, however, to foreclosure under the power of sale of the trust indentures, in which case deficiency judgments would be entered without appraisal and without limitation as provided in Section 726.

Bank of America v. Burg Bros., 31 Cal. App. (2d) 352;

Kirkpatrick v. Stelling, 100 Cal. App. Dec. 335;

Pac. States Sav. & Loan v. Painter, et al., 100 Cal. App. Dec. 860.

But in these proceedings we are concerned with the fairness of a plan of reorganization and not with the obstacles which might or might not be placed in the way of bondholders if foreclosure were necessary. None of the points presented by petitioners can justify the arbitrary cancellation of the indebtedness of Consolidated, which, if paid only in small part, would make bondholders whole. It follows that the Circuit Court of Appeals correctly declared that so long as this indebtedness is in dispute, some determination with respect to the dispute is essential to intelligent consideration of any future plan which may be presented in these proceedings.

POINT II.

The Court's Insistence Upon a Determination of the Values Involved.

The Circuit Court of Appeals closed its opinion with the following language:

> "While we agree that the 'values' of the various properties is necessary to a complete determination as to the fairness of any plan, and that a 'fresh examination into such question' should be made, no arguments are made on the question as to whether we have power to direct an appraisal. Under these circumstances we think we should leave the question open and, while expressing the opinion that an appraisal should be made, merely say that precise findings as to values must be made." [R. 380.]

Petitioners seize upon this language as a ruling "that in every 77B reorganization there must be a minute appraisal to ascertain the precise value of the properties involved. . . ."

The Circuit Court of Appeals did not so hold.

In filing objections to the plan respondent prayed that an impartial and qualified appraiser be appointed to appraise all properties of Union and Consumers [R. 107]. At the opening of the hearing before the Special Master he moved that an appraisal be made of the properties securing the Union bonds, the properties securing the Consumers bonds and the properties proposed to be contributed to the new corporation by Consolidated [R. 271]. Decision was deferred until completion of the testimony. At that time respondent renewed his motion and it was taken under

submission [R. 272], but denied by the Special Master's findings and report, reading in part as follows:

> ". . . The evidence developed that there has been such a commingling of the assets and properties, including the funds from the sale of stock of Consolidated, that an appraisal of the properties would be of no value to the court and would be of such indefinite and unsatisfactory nature as to produce further confusion, and a separate, independent appraisal would result in unnecessary and great delay and expense to all parties. Its benefits would be highly problematical." [R. 158.]

Respondent's exception to this ruling of the Special Master [R. 199-200] was denied. On appeal respondent assigned as error the failure of the District Court to evaluate the interests of the respective parties to the plan and the denial by the District Court of respondent's exception to the report of the Special Master with respect to appraisal [R. 331, 337-339].

It is not the contention of respondent that a formal appraisal must be had in every case under §77B. He has, however, contended that under the circumstances of this case an appraisal should have been directed. The Circuit Court of Appeals pointed out the inconsistency of the findings below, saying:

> "It has been found that the assets have been so commingled that identification thereof is impossible, yet findings are made to the effect that assets subject to the trust indentures are insufficient to pay the principal of and interest on the bonds." [R. 374.]

The same inconsistency runs throughout the case. Respondent's motion for appraisal was opposed upon the ground that the assets of the various companies had been so commingled that segregation and appraisal were impossible. Yet the officers of Consolidated, Mr. Mitchell and Mr. Gautier, later appeared and seemed to have no difficulty in testifying to the value of the various properties. Their testimony is unsatisfactory when compared with the balance sheets of Consolidated filed with the court. The balance sheet as of September 30, 1937, shows liabilities of the united enterprise exceeding assets by $570,597.08. The balance sheet as of June 30, 1938 [R. 316], shows insolvency to the extent of $529,486.26. Mr. Mitchell and Mr. Gautier were the only witnesses before the court on the important question of the value of the assets of Consolidated—the company of which they were in active charge.[3]

Before the Special Master there was evidence that in 1929 on appraisal by J. G. White Engineering Corporation the value of the Union and Consumers assets was placed at $15,000,000 [R. 281]. An appraisal by Consolidated in 1931 placed the value of all properties at $4,414,425 [R. 281]. The consolidated balance sheets of Consolidated and

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[3]It cannot be contended that the burden of establishing the value of the properties involved should be borne by dissenting creditors. In *First National Bank v. Flershem*, 290 U. S. 504, at 525 and 526, this Court said:

> "In receivership proceedings, as was held in National Surety Co. v. Coriell, 289 U. S. 426, 436, every important determination by the court calls for an informed, independent judgment; and special reasons exist for requiring adequate, trustworthy information, where the jurisdiction rests wholly upon the consent of the defendant who joins in the prayers for relief. It would be unconscionable to impose upon a few dissenting creditors the heavy financial burden of making adequate appraisal, supported by the testimony of competent experts, where, as here, the assets include extensive plants and equipment located in nine states."

its subsidiaries referred to above showed liabilities exceeding assets. Adding to the confusion was the conflicting testimony of the three witnesses who testified to value. It is difficult to understand how the Special Master concluded under these circumstances that an independent appraisal by a competent court appraiser would not have aided him in finding his way out of the maze of conflicting figures.

More certainty with respect to the value of the properties of the various companies here involved is essential to that informed and independent judgment required in proceedings such as these.

Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 115;

First Nat. Bank v. Flershem, 290 U. S. 504, 525;

National Surety Co. v. Coriell, 289 U. S. 426, 436.

Seemingly, the Special Master and the District Court considered the past history of Consolidated and its subsidiaries of greater importance to a determination of fairness than the present value of the properties involved in the plan. This is shown in the failure of the Special Master to make separate findings as to the Union and Consumers properties, although objection to the plan was made upon the ground, among others, that as between Union and Consumers bondholders the plan discriminated in favor of the latter [R. 101]. It is plain that the application of the full priority rule requires reasonably accurate determination as to the value of properties against which creditors are entitled to full priority. The decision of the Circuit Court of Appeals, while suggesting the advisability of appraisal under the circumstances of this particular case, does no more than insist upon such determination.

POINT III.

The Elimination of the Present Union and Consumers Bonds.

Petitioners attack the decision of the Circuit Court of Appeals as ruling that the plan in the instant case is unfair in providing for the substitution of a common issue of bonds for the present Union and Consumers bonds. In his brief in opposition to certiorari herein respondent has fully stated his position on this point. The decision of the Circuit Court of Appeals, as respondent reads it, declares the plan herein to be unfair simply because it fails to accord full priority to bondholders of the subsidiaries to the extent of their debts. While there is some uncertainty in the language of the court when the decision is read piecemeal, such uncertainty disappears when it is considered in its entirety. The point is one which might be of some importance to Union and Consumers bondholders, but it is seized upon here by petitioners despite the fact that it in no way involves the question of the fairness of the plan as between bondholders and the stockholders of Consolidated.

Following after a discussion of the full priority rule as reaffirmed in *Case v. Los Angeles Lumber Products Co., Ltd., supra*, the decision of the Circuit Court of Appeals states the basis of the finding that the plan here involved is unfair in the following language:

> "It is obvious that the plan here is condemned by these rules. The trial court found that the property of Union covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Union, yet the Union bondholders are deprived of their right to full priority against Union's assets, since *Consumers' bondhold-*

> *ers and* debtor's preferred stockholders are given an interest in Union's property. Likewise, the trial court found that the property of Consumers covered by the trust indenture was insufficient to pay the principal and accrued interest of the bonds issued by Consumers, yet Consumers' bondholders are deprived of their right to full priority against Consumers' assets, since *Union bondholders and* debtor's preferred stockholders are given an interest in Consumers' property. Exactly in point, as to facts, is Case v. Los Angeles Lumber Co., *supra*. Since the order must be reversed on the ground that the bondholders have not been accorded full priority, it is unnecessary to discuss other charges of unfairness in the plan, some of which appear to be sound." [R. 377.] (Italics ours.)

Petitioners here, as well as the petitioners in Docket No. 444, interpret the quoted language, particularly because of the words italicized by respondent, as holding that the full priority rule is violated by the cross-participation of the two groups of bondholders in the properties securing their respective bonds. The italicized words create some uncertainty, but petitioners' strained interpretation of the decision is shown by the obvious import of the opening and closing sentences of the quoted paragraph.

Respondent considers the italicized words unfortunate and unnecessary. It is his position that if the decision is properly interpreted by petitioners here and by the petitioners in Docket No. 444, then the decision should be corrected on the authority of the cases cited by the two groups of petitioners. Such correction, however, need not affect the primary issue of fairness, for the plan's invasion of the bondholders' rights for the benefit of stockholders is the paramount consideration.

POINT IV.

The Plan Is Unfair.

1. FAIRNESS OF THE PLAN MUST BE DETERMINED BY APPLICATION OF THE RULE OF FULL OR ABSOLUTE PRIORITY OF CREDITORS.

In seeking review by this Court on certiorari the principal contention of petitioners was that the full or absolute priority rule of *Case v. Los Angeles Lumber Products Co., Ltd., supra,* and of the earlier equity reorganization decisions of this Court, could have no application to the instant case. They argued that the rule is applicable only to reorganization of insolvent corporations, and that since the Special Master in the instant case had found the united enterprise—Consolidated considered collectively with its two subsidiaries, Union and Consumers—to be solvent, the absolute priority rule could not be applied.

Apparently petitioners have abandoned this theory. However, they still insist that the facts of the *Lumber Company* case differ so radically from those presented on this review that the decision cannot serve as controlling authority.

A considerable portion of their brief is devoted to compilations of figures to establish the solvency of the united enterprise, and of both Union and Consumers as well. Petitioners, however, present no reasoning, nor cite any authority, for exempting solvent corporations in reorganization from the full priority rule of the *Lumber Company* case.

The facts of the two cases may differ in some respects, but the governing principles are the same. Respondent does not believe that at this late date it will be seriously

questioned that in all reorganizations under §77B of the Bankruptcy Act our courts must be guided by the "fixed principle" of *Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482, reaffirmed in *Kansas City Terminal Railway Co. v. Central Union Trust Co.,* 271 U. S. 445, that

> "to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation."

This language merely rephrases the "familiar rule" reaffirmed by this Court in *Louisville Trust Co. v. Louisville, New Albany & Chicago Ry. Co.,* 174 U. S. 674, that

> "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors."

Today it is firmly established by the decisions of this Court, to use the language of *In re New York Railways Corporation,* 82 Fed. (2d) 739, 742, that

> "stock equity may not be allowed to participate in any plan of reorganization which does not first provide for making creditors whole."

The same logic which requires the application of these rules to insolvent corporations requires their application to solvent corporations. In either case, in the language of this Court in *Kansas City Terminal Ry. Co. v. Central Union Trust Co., supra,*

> "any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights * * * of creditors comes within judicial denunciation."

The plan need only be examined in the light of these controlling principles, so recently reaffirmed by this Court in *Case v. Los Angeles Lumber Products, Ltd., supra.*

2. THE DISREGARD OF THE FULL PRIORITY RULE.

Viewed against the factual background of the case it is evident that the plan is unfair to Union and Consumers bondholders in the following respects:

(a) Despite the fact that the principal of presently outstanding bonds is secured 100%, Union and Consumers bondholders are compelled to accept non-cumulative preferred stock in substitution for 50% of the principal amount of the bonds now held by them.

(b) Accrued and unpaid interest on outstanding bonds, amounting to $625,270, is cancelled although the bondholders now have a first lien on assets of such value that a minimum of $286,000 remains to be applied in payment of accrued interest after full provision for the principal of the bonds.

(c) Cancellation of inter-company obligations results in discharge of indebtedness owing by Consolidated to Union and Consumers in excess of $5,000,000. Such indebtedness constitutes an asset against which the bondholders, as creditors of Union and Consumers, are entitled to full priority over stockholders of Consolidated. Should it be paid, even in small part, Union and Consumers would be able to discharge the small balance of accrued interest which would remain after application to their bonds of the assets admittedly covered by their respective trust indentures.

(d) The new income bonds to be substituted for 50% of the principal amount of present bonds will bear interest at the rate of 5% as compared to the 6% rate now stipulated. No default under the indenture will occur, however, unless during the first two years the interest paid does not aggregate 4%, or an average of 2% per annum, or unless during the first five years the interest paid does not aggregate 16%, or an average of 3.2% per annum [R. 42].[4] Even if the full 5% interest on the new bonds is paid regularly the interest income of present Union and Consumers bondholders will be but 41⅔% of the interest income to which they are entitled on their present bonds.

(e) Bondholders are compelled to extend the time for payment of their bonds to April 1, 1957.

(f) Present preferred stockholders of Consolidated, without payment of any consideration and without sacrifice on their part, preserve their present equity position despite the sacrifices exacted of Union and Consumers bondholders.

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[4]The leniency of the default provisions with respect to the new bonds is striking. If on April 1, 1939, interest aggregating 4%, or 2% per annum, has been paid during the preceding two years, the new corporation need pay no interest during the next three years ending April 1, 1942. At that date, not having paid the required aggregate of 16% during the preceding five years, the corporation will be in default. But bondholders will have no right to foreclose, for no right of foreclosure "shall accrue until the expiration of two years after the occurrence of any such event of default, and then only if such event of default shall not have been remedied" [R. 43]. Before the expiration of the five-year period the new corporation need only pay the delinquent required interest to cure the default.

(g) Present common stockholders of Consolidated, having no equity whatever, are granted the right to acquire common stock of the new corporation at a price of $1.00 per share, while the same stock is subject to purchase by Union and Consumers bondholders only at prices graduating from $2.00 to $6.00 per share.

3. THE PLAN CONTEMPLATES AN INVASION OF THE PROPERTY RIGHTS OF THE BONDHOLDERS FOR THE BENEFIT OF STOCKHOLDERS OF CONSOLIDATED.

Every step of the plan in its treatment of Union and Consumers bondholders constitutes a definite invasion of their property rights.

Louisville Joint Stock Bank v. Radford, 295 U. S. 555.

Full priority to the extent of their debts against the assets of their debtors is denied them. One-half of bond principal, now secured 100%, is taken from the bondholders to be replaced by non-cumulative preferred stock; accrued interest amounting to $625,270, which is secured in part, if not in whole, is arbitrarily cancelled; interest income is reduced and the time for payment of the bonds extended. Such treatment might be justified if the security for the bonds had shrunk to a point where the bondholders could have no reasonable anticipation of payment therefrom. Here, however, the situation is entirely different, for the assets of Union and Consumers admittedly subject to their trust indentures are almost sufficient to discharge the full interest and principal on the bonds, and Consolidated is indebted to the subsidiaries to an extent which would insure full payment.

The disregard of the full priority rule is climaxed by the plan's cancellation of this indebtedness.

Each step of the plan confiscates the property rights of the bondholders; each step improves the position of the present preferred stockholders of Consolidated in their succession to the common stock of the new corporation; each step enhances the value of the stock equity and insures control of the new corporation by the present stockholders of Consolidated.

For the sacrifices exacted of them the plan offers the bondholders no compensation. Not even one share of the common stock of the new corporation is given them by way of compensatory treatment. While present preferred stockholders of Consolidated receive 285,947 shares of the new common stock because of transfer by Consolidated to the new corporation of its assets, found by the Special Master to be worth $1,000,000,[5] present bondholders receive not one share to compensate them for the cancellation of accrued interest of $625,270.

The preferred stockholders of Consolidated exchange their present stock, share for share, for the common stock of the new corporation. No contribution or sacrifice of any kind is demanded of them. Today they own all equit in the united enterprise under the lien of the bonds; the plan preserves in them that same equity, but enhanced

[5]The figure of $1,000,000. includes an astronomical figure of $500,000. for good will. Consolidated has been operating since 1929, yet in no year since its organization, except 1929, has it shown net earnings available for dividends, after payment of or provision for all charges [R. 190-191]. The valuation of $500,000. placed on good will by the witness Mr. Mitchell is in excess of the total net operating profit of the company, before bond interest and provision for depreciation, depletion, amortization and like charges for the four-year period, 1934-1937, inclusive [R. 190].

in value by the sacrifices exacted of present bondholders. Everything which is taken from the bondholders inures to the benefit of the present stockholders; they benefit in direct proportion as the bonded indebtedness is repudiated and the property rights of the bondholders confiscated.

In final analysis, the plan is simply an arrangement of the parties by which the subordinate rights and interests of stockholders are enhanced at the expense of the prior rights of the bondholders.

The proponents of the plan have sought to justify it on the grounds that (1) Consolidated is cancelling Union and Consumers bonds held by it in the principal amount of $166,000; (2) present bondholders receive stock purchase warrants entitling them to purchase common stock of the new corporation; and (3) Consolidated is contributing to the new corporation its allegedly free assets.

No justification for the plan can be found in the cancellation of the $166,000 of Union and Consumers bonds. As noted in considering the indebtedness of Consolidated under the operating agreement, that corporation is indebted to the subsidiaries in an amount many times greater than the face amount of bonds held by Consolidated. Even disregarding the $5,000,000 indebtedness of Consolidated resulting from depreciation and depletion of the Union and Consumers properties, Consolidated is indebted to the subsidiaries on current account transactions in the sum of $842,710.18. The subsidiaries are indebted to Consolidated on current account transactions only to the extent of $586,111.62. Offsetting, and allowing for the $166,000 of Union and Consumers bonds, Consolidated still remains liable on the current account item alone in the sum of $90,598.56 [R. 316].

Nor can the plan's treatment of the bondholders be justified by the fact that the new preferred stock to be issued will carry stock purchase warrants entitling present bondholders to purchase two shares of the common stock of the new corporation for each share of the new preferred. The warrants have only a highly speculative, if any, value. They are but an invitation to bondholders to make further investment in the enterprise, and in no sense can they be considered as affording compensatory treatment to bondholders for loss of their accrued interest or for their change from a creditor to a stockholder position. In its brief as *amicus curiae* on rehearing before the Circuit Court of Appeals the Securities and Exchange Commission ably demonstrated that to make the bondholders whole for accrued interest alone, the new common stock will have to attain a value of from $12.40 per share (if the warrants are exercised within the first six months) to $16.40 per share (if the warrants are exercised during the fifth year after issuance). It further pointed out that if the warrants to be issued under the plan to present common stockholders of Consolidated are also exercised in full, a market value for the new common shares of between $5,281,474 and $6,984,346 will have to be justified. This is approximately five times the present value of the equity in the united enterprise asserted by petitioners in their brief.

The plan's discrimination in favor of the stockholders of Consolidated is strikingly shown in the treatment of present common stockholders who have no equity whatever. There are 397,455 common shares now outstanding. Under the plan stock purchase warrants will be issued to common stockholders permitting them to purchase one share of the new common stock for each five shares now

held, at a price of $1.00. If such warrants are exercised within the three months' period allowed, present common stockholders, for an investment of $79,491, will receive 79,491 shares of the new common stock. If present bondholders exercise their warrants within the first six months, they will be entitled to purchase a total of 60,280 shares of the new common stock at $2.00 per share, or a total of $120,560.00.

Thus it is seen that not only are present preferred stockholders of Consolidated preferred over the bondholders, but so too are common stockholders who have no right whatever to participate in the plan.

Case v. Los Angeles Lumber Products Co., Ltd., supra;

In re 620 Church Street Bldg. Corp., 299 U. S. 24.

The fact that Consolidated will transfer its assets to the new corporation likewise fails to justify the plan. These assets are already in the united enterprise; already they are indirectly charged with liability for payment of existing Union and Consumers bonds because of the huge indebtedness of Consolidated to the subsidiaries. Consequently transfer of these assets is in reality made by the bondholders to the extent that the plan does not make them whole. But even if we assume that these are free assets, their transfer to the new corporation affords no compensatory treatment to bondholders. No benefit will flow to bondholders by reason of the transfer, and the present preferred stockholders of Consolidated will continue their present indirect ownership of the assets. That ownership today is evidenced by preferred stock

of Consolidated; if the reorganization is consummated it will be evidenced by new common stock; the change is one of form and not of substance.

It will be urged that the assets of Consolidated will be subjected to the lien of the new bonds. The present bonds are secured 100% as to principal. The new issue will be more than 50% less in principal amount than the present issues. Consequently the new bonds will have a two to one security entirely independent of the allegedly free assets of Consolidated. Additional security is not required, and to offer the assets of Consolidated for such purpose is a mere gesture.[6]

Thus the considerations relied upon by petitioners as supporting the plan afford no real compensation to bondholders for their drastic treatment under the plan.

The foregoing discussion shows that in this plan of reorganization the full priority rule of *Case v. Los Angeles Lumber Products Co., Ltd., supra,* and the earlier reorganization decisions of this Court, is entirely disregarded. The plan here simply contemplates the scaling down of corporate debts without compensatory treatment. It was not the purpose of Section 77B to permit a corporate debtor to shed its debts and to improve its position at the expense of its creditors.

Yet that is exactly what is accomplished by the plan here involved.

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[6]The aggregate principal amount of the Union and Consumers bonds now outstanding is $3,180,000., this figure including the $166,000. of bonds held by Consolidated. The aggregate principal amount of the new bonds to be issued under the plan is 1,507,000.

Aside from the problem of bonded indebtedness, Consolidated and its subsidiaries are in good financial condition [R. 312]. Annual interest on outstanding bonds publicly owned amounts to $180,840 [R. 191-192]. In 1936 the operating profit of Consolidated, before bond interest and reserves for depreciation, depletion and amortization, amounted to $201,632.29, or over $20,000 in excess of interest requirements on present bonds. Again in the first nine months of 1937 alone, an operating profit of $199,890.82 was made. This amount covered interest requirements for the full year, with a surplus over, and with fourth quarter income not reported [R. 190]. Even more striking is the earnings record for the first five months of 1938 ending June 30th [R. 315]. In these five months the operations of Consolidated and its wholly owned subsidiaries returned a consolidated net profit of $25,255 after full provision for current interest and for depletion, depreciation and amortization [R. 315, 312]. These facts further demonstrate the essential unfairness of the plan to present bondholders.[7]

Respondent submits that the plan here must meet with judicial denunciation under the definite rules reaffirmed by this Court in *Case v. Los Angeles Lumber Products Co., Ltd., supra.* In the lower courts somewhat similar plans have been rejected under analogous conditions.

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[7]The hearing before the Special Master was concluded November 17, 1937. The order of the District Court confirming the plan of reorganization was not filed until September 8, 1938. Shortly prior to August 1, 1938, respondent moved the court to reopen the hearing in order that the changed condition of Consolidated and its wholly owned subsidiaries reflected in the balance sheets as of June 30, 1938, might be considered. The motion to reopen was denied [R. 312].

In *In re Day & Myer, Murray & Young, Inc.*, 2 Cir. 93 Fed. (2d) 657, the reduction of bonded indebtedness by one-half was condemned when the evidence showed the value of the mortgaged property to exceed the principal of the bonded indebtedness. In that case, as well as *In re Barclay Corporation*, 2 Cir., 90 Fed. (2d) 595, the cancellation of accrued interest to build up an equity for junior interests was also condemned.

The lower courts have repeatedly rejected plans which, as here, discriminate unfairly in favor of the stockholders and disregard the prior rights of bondholders. Typical of such cases are *Sophian, et al. v. Congress Realty Co.*, 8 Cir., 98 Fed. (2d) 499; *Wayne United Gas Co. v. Owens-Illinois Glass Co.*, 4 Cir., 91 Fed. (2d) 827; *Price v. Spokane Silver & Lead Co.*, 8 Cir., 97 Fed. (2d) 237.

Here, as previously stated, the vice of the plan is found in its appropriation of the properties against which bondholders are entitled to full priority, and transfer of such properties, in effect, to stockholders.

The closing language of the decision of this Court in *Louisville Joint Stock Land Bank v. Radford, supra,* seems peculiarly appropriate. We quote from pages 601 and 602 of the decision, as follows:

> "The province of the Court is limited to deciding whether the Frazier-Lemke Act as applied has taken from the bank, without compensation, and given to Radford, rights in specific property which are of substantial value. . . . As we conclude that the Act as applied has done so, we must hold it void.

> For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public."

In the cited case only an individual mortgagor and an individual mortgagee were involved; but the rule which there protected the individual mortgagee must here with equal force protect the Union and Consumers bondholders, as a collective group of mortgagees, from confiscation of their property rights for the benefit of stockholders of Consolidated, as a collective group of mortgagors.

4. The Plan as Between Union and Consumers Bondholders Is Unfair to the Former.

Not only is the plan unfair to both Union and Consumers bondholders, but it is particularly unfair to the former.

The plan provides for new Series U bonds in the amount of $938,500 and new Series C bonds in the amount of $568,500, the former for Union bondholders, the latter for Consumers bondholders [R. 27]. Income is to be divided equally between the two series, and upon their retirement, between the two corresponding series

of preferred stock [R. 33-34; 47]. It is apparent that this favors Consumers bondholders over Union bondholders.

The proponents of the plan attempt to justify this discrimination by showing that under the management of Consolidated the Consumers properties have for some years past been so operated as to contribute a greater proportion of the income of the united enterprise than the Union properties [R. 289]. The criterion is a false one, for Consumers' larger contribution to income is the result of a business policy dictated by circumstances which disclose the essential strength of Union and the essential weakness of Consumers. The situation was well presented during the course of these proceedings by a letter from Mr. Mitchell, then secretary of Consolidated, sent by order of its board of directors to all Consumers bondholders on June 4, 1936 [R. 303-311]. Explaining the reason why Consumers plants were contributing more to the income of the joint operation than Union, Mr. Mitchell said:

> "When the volume of business was continually decreasing it became necessary to temporarily abandon certain plants and concentrate operations in others. Statements may have been made to you that the Consumers plants have been operated and kept up continuously while the Union had not, and that the reason for so doing was that the Consumers plants were more valuable. It is true that more of the major plants of Consumers were operating. However, the reason is simple and sound. The major Consumers plants, with one exception, are on leased properties which require the payment of large mini-

mum rents and royalties. Many of the Union plants are on property owned in fee where the only carrying charges are taxes. Obviously the Consumers plants—where minimum royalties had to be paid—were the ones to be operated. This was done and accounts for the fact that during the bottom of the depression the Consumers plants were more actively in operation and sold more tonnage than the Union. With the upturn in business, which started in the middle of 1935 and has since continued, Union plants are now being revamped and placed in active operation. In the past three months two of these have been completely overhauled and are now actively operating. The operation of the Consumers plants during the low period did not impair your security. There is sufficient rock, sand and gravel on these properties to last indefinitely. The plants have been well maintained and it is indisputable that they could not have all been maintained and operated had Consumers not been a part of Consolidated [306]."

The foregoing statement demonstrates the falsity of the criterion used in the allocation of the income of the new corporation under the plan—one-half to Union and one-half to Consumers.

We have previously noted that the Special Master for some reason did not value the Union and Consumers properties separately. The testimony of witnesses to value, however, has been tabulated above (*supra*, p. 9).

From the tabulation it is seen that the valuation most favorable to Consumers in relation to Union, that of Mr.

Gautier, shows Union assets worth $504,000 more than those of Consumers. The valuation most favorable to Union, that of Mr. Rogers, shows its properties worth $1,768,000 more than Consumers. The third valuation, by Mr. Mitchell, shows Union worth $883,100 more than Consumers.

In the face of the much greater value of the Union assets and of the much greater Series U bonds to be serviced, income under the plan is to be equally divided.

This discrimination against Union in allocation of income is visually presented by the table showing the respective contributions of Union and Consumers to the new corporation proposed by the plan [R. 285]. Union contributes almost twice as much acreage devoted to plants, approximately eight times the acreage devoted to bunkers, and approximately five times as much non-operative acreage. And while most Union acreage is owned in fee, by far the greater part of Consumers acreage consists of leaseholds.

The proposed income division in the face of this evidence cannot be justified by the results of a depression business policy. Had the operations of Consolidated during the depression decreased so that the leased properties of Consumers could have supplied all demand without operation of any Union plants, then Union, judged by the criterion of income division of the plan, would be entitled to nothing.

The unfairness to Union bondholders is apparent.

Conclusion.

In closing their brief the petitioners urge that the plan in the instant case should be confirmed because (1) the present plan was formulated after long delay and strenuous effort; (2) the $7,000,000 investment made in 1929 by the present stockholders of Consolidated has not proved a profitable one; and (3) respondent, who alone appealed from the judgment of the District Court, purchased his bonds at depression prices and is therefore a "speculator". Such considerations, respondent submits, are foreign to a determination of whether the plan is fair and equitable. But in passing it should be noticed that of the $7,000,000 invested by the stockholders of Consolidated in 1929, only $500,000 went into the corporation by way of new working capital [R. 279]. This figure is in striking contrast to the cash of $380,000 and receivables of $750,000 which Consolidated took over from Union and Consumers upon the inception of the unified operation [R. 139].

In his brief in opposition to certiorari herein respondent presented his status as an objector to the plan. There it was shown that prior to the filing of these proceedings he had become the owner of $72,000 of his Union bonds and of all his $31,500 of Consumers bonds. In no sense has he been a speculator in the bonds or an obstructionist in these proceedings. What he paid for his bonds makes this plan neither fair nor unfair; in any case he is entitled to nothing more than a fair plan. He has opposed this plan as patently unfair to the bondholders and unfairly

discriminatory in favor of the stockholders of Consolidated. That opposition has been made in good faith and without the use of anything even slightly suggestive of obstructionist tactics.

Respondent respectfully submits that the decision of the Circuit Court of Appeals is correct and should stand.

Respectfully submitted,

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